

## NOTE 14 – OTHER LONG-TERM OBLIGATIONS

### A. Primary Government

#### Other Long-Term Obligations

In general, expenditures and fund liabilities are not recorded in governmental funds for long-term obligations until claims, judgments, or amounts owed are "due and payable" at September 30. Expenses and liabilities for material claims and judgment losses are recorded in the government-wide and proprietary fund financial statements when the loss is considered probable.

#### Capital Leases

This liability is described in more detail in Note 11.

#### Compensated Absences

This liability is described in Note 1.

#### Workers' Compensation

The gross amount of workers' compensation liability, \$311.0 million at September 30, 2002, has been recorded at its discounted present value of \$208.8 million, using a discount rate of 8%. The present value of the current portion of this liability is \$46.2 million. The Accident Fund Company billed State agencies for actual workers' compensation claims paid plus administrative fees, totaling \$51.9 million in fiscal year 2001-2002.

#### Net Pension Obligation

This liability is described in Note 10.

#### Other Claims & Judgments

The governmental activity estimated liability for other claims and litigation losses, \$364.9 million at September 30, 2002, includes amounts for litigation, such as damages in tort cases and refund

claims in cases involving State taxes, transportation claims, natural resources and environmental quality claims, and other claims, in which it is considered probable that costs will be incurred. Also included is an estimated liability totaling \$4.2 million for arbitrage payable to the federal government for interest earned on bond proceeds. Where a range of potential loss exists, the amount recorded is based upon the expected minimum amount that will be lost if the State does, indeed, lose. The allowance also includes projections for highway related negligence cases based upon historical loss ratios. The State continues to vigorously contest all of these claims and the State may incur no liability in the individual cases involved. Therefore, the allowance for litigation losses may be overstated (to the extent that losses do not occur) or understated (if the State losses exceed the projected minimums which have been recorded). The maximum potential loss on the allowance for estimated litigation losses is not considered reasonably measurable.

The liability recorded for other claims and judgments within business-type activities represents overpayments by employers to the Michigan Unemployment Compensation Fund totaling \$43.6 million.

#### Durant Settlement

The reported estimated liability for litigation losses includes the Donald Durant, et al v State of Michigan, et al consolidated cases, which totaled \$391.0 million at September 30, 2002. This amount will, over time, be paid to each "non-Durant" school district for its underfunded State mandated program costs if certain requirements are met. See Note 23 for additional disclosure regarding the Durant case and other contingencies.

#### Changes in Other Long-Term Obligations

Changes in long-term liabilities for the year ended September 30, 2002, are summarized as follows (in millions):

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year	Amounts Due Thereafter
<b>Governmental Activities</b>						
Other Long-term Obligations:						
Capital lease obligations	\$ 254.8	\$ 256.3	\$ 49.7	\$ 461.4	\$ 38.2	\$ 423.2
Compensated absences	437.7	239.5	259.4	417.8	43.2	374.6
Workers' compensation	199.9	54.0	45.1	208.8	46.2	162.6
Net pension obligations	19.5	10.7	-	30.2	-	30.2
Other claims & judgments	632.5	610.2	877.9	364.9	108.8	256.1
Durant settlement	451.0	-	60.0	391.0	60.0	331.0
Total Governmental Activities	<u>\$ 1,995.4</u>	<u>\$ 1,170.7</u>	<u>\$ 1,292.0</u>	<u>\$ 1,874.1</u>	<u>\$ 296.3</u>	<u>\$ 1,577.7</u>
<b>Business-type Activities</b>						
Other Long-term Obligations:						
Lottery prize awards*	\$ 764.0	\$ -	\$ 80.4	\$ 683.6	\$ 129.1	\$ 554.5
Compensated absences	3.1	1.1	2.0	2.2	.4	1.7
Other claims & judgments	42.0	1.6	-	43.6	-	43.6
Total Business-type Activities	<u>\$ 809.1</u>	<u>\$ 2.7</u>	<u>\$ 82.4</u>	<u>\$ 729.4</u>	<u>\$ 129.5</u>	<u>\$ 599.9</u>

\*The amounts due within one year are included with "Accounts payable and other liabilities" on the Statement of Net Assets.

The General Fund, special revenue, and internal service funds in which the leases are recorded will liquidate the capital lease obligations. The compensated absence and workers' compensation liabilities will be liquidated by the applicable governmental and internal service funds that account for the salaries and wages of the related employees. The net pension obligations will be liquidated by the State's governmental and

internal service funds that contribute toward the pension funds, based on the statutorily required contribution rates. The School Aid Fund will liquidate the Durant settlement. Other claims and judgments attributable to governmental activities will generally be liquidated by the General Fund and transportation related special revenue funds.

## **B. Discretely Presented Component Units**

### **Michigan Education Trust (MET)**

MET offers contracts which, for actuarially determined amounts, provide future tuition at State institutions of higher education. Contract provisions also allow the benefits to be used at private or out-of-state institutions, with the amount provided being based upon rates charged by the State's public institutions of higher education. The tuition payments are made by MET as a separate legal entity and these contracts are not considered obligations of the State. The Legislature is not obligated to provide appropriations should losses occur. The statutes and contracts provide for refunds to the participants if MET becomes actuarially unsound. Liabilities have been recorded on the statement of net assets for the actuarial present value of future tuition benefit obligations.

The 1988, 1989, and 1990 enrollments are known as Plans B and C. Enrollments after November 1995 are known as Plan D.

The actuarial report on the status of MET Plans B and C, as of September 30, 2002, shows the actuarial present value of future tuition obligations to be \$641.3 million, as compared to the actuarially determined market value of assets available of \$724.9 million. The actuarial assumptions used include: a projected tuition increase rate of 5.80% for the years through 2008 and 7.30% for subsequent years; and a discount rate of 5.27%.

The actuarial report on the status of MET Plan D, as of September 30, 2002, shows the actuarial present value of future tuition obligations to be \$206.4 million, as compared to the actuarially determined market value of assets available of \$193.5 million. The actuarial assumptions used include: a projected tuition increase rate of 5.84% for the years through 2008 and 7.30% for subsequent years; and a discount rate of 7.00%.

On November 8, 1994, the U.S. Court of Appeals for the Sixth Circuit ruled that MET is an integral part of the State of Michigan and, thus, the investment income realized by MET is not currently subject to federal income tax. On August 20, 1996, the Small Business Job Protection Act of 1996 (the "1996 Tax Act") was signed into law which included a provision adding a new section to the Internal Revenue Code of 1986 defining "qualified state tuition programs." A qualified state tuition program is generally exempt from income tax, but is subject to unrelated business income tax. MET has no unrelated business income. Distributions made in excess of contributions (whether to the refund designee, beneficiary, or to a college on behalf of the beneficiary) are taxable income to the beneficiary or the refund designee. The Internal Revenue Service (IRS) was expected to release regulations in 2000, which would have clarified the 1996 federal legislation for qualified state tuition programs. In May 1997, MET submitted a request for ruling to the IRS for verification that MET is in compliance with the 1996 Tax Act. On December 23, 1997, the IRS issued a favorable ruling which confirms that MET is in compliance with the Act.